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No. 86-860

In the Supreme Court of the United States

October Term, 1986

WALTER T. WALKER, III
Petitioner,

v.

ACTION INDUSTRIES, INC., AMOS COMAY, ERNEST BEREZ and SHOLOM COMAY,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

Brief For Respondents In Opposition

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QUESTION PRESENTED*

Did the U.S. Court of Appeals for the Fourth Circuit err by affirming a jury verdict that respondents did not violate securities laws where the jury was instructed that respondents had no duty to disclose the unique internal sales projections at issue in this case, which projections were held to be so misleading and constantly changing that it was unreasonable to mandate their disclosure under the legal standard of any court of appeals?

*Action has not addressed Petitioner's Second and Third Questions Presented as the issues raised therein are neither "special" nor "important" within the meaning of Supreme Court Rule 17.

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COUNTERSTATEMENT OF THE CASE

Respondents, Action Industries, Inc., Amos Comay, Ernest Berez and Sholom Comay (hereinafter referred to as "Action" or "respondents"), while not wanting to overburden this Court, find it necessary to present a counterstatement of the case because petitioner has mischaracterized both the factual aspects of this case and the holdings of the courts below.

(a) Action's Business and Its Internal Planning Documents.

Action is a Pennsylvania corporation[1] engaged in a unique business which involves the sale of promotional programs, for which Action provides the advertising, the products, and the on-site displays. 802 F.2d at 704; J.A. 711-713.[2] Although Action prepares for these programs in advance, any such program is subject to complete or partial cancellation, indefinite postponement, or other changes by the customer, with any corresponding losses absorbed by Action. Such cancellations are very common in Action's business. 802 F.2d at 710; J.A. 715-716.

Most of Action's business is done with a small number of large retail discount store chains (e.g., K mart, Sears, Roebuck & Co., Zayre), a fact which makes Action particularly vulnerable to sudden swings in business. J.A. 711-715. Because these customers are much larger in size than Action and have developed their own sophisticated marketing departments, after utilizing Action's services for a

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[1]Pursuant to Supreme Court Rule 28.1, Action Industries, Inc., notes that it has two non-wholly-owned subsidiaries, Action Tungsram, Inc., a Pennsylvania corporation, and Action Nicholson Color Co., an Ohio corporation.

[2]References to the joint appendix submitted to the court of appeals are denoted by "J.A." followed by page numbers.

period of time, they often become Action's "competitors." J.A. 712-713, 2422. At the time relevant to this suit (mid-1982), as noted by the court of appeals, many of Action's largest customers were in "extremely shaky" financial condition. Consequently, Action's in-house sales projections at all times reflected "evident uncertainty . . . and volatility." 802 F.2d at 710. *See also* J.A. 713-716, 757-761.

Action prepares a number of documents for internal planning purposes. The documents known as "Flash Sales Reports" reflect, on a weekly basis, promotion shipments that have been completed by Action. 802 F.2d at 705; J.A. 471-473. Action also prepares a listing of anticipated promotions that are updated on a weekly basis to account for shipping changes, cancellations, and postponements. These "Weekly Work Projections" are summarized on a monthly basis in a document entitled "Dollar-Ama Gross Sales Forecasts." J.A. 538-544. These documents list Action's projected promotional programs as either "firm" or "anticipated" for internal planning purposes. 802 F.2d at 705. Action's officials testified that "firm" on these summaries meant that Action had to begin preparing for the promotion in order to be able to perform it on time. J.A. 529-530, 727.

Because of constant uncertainty in sales, cancellations and the resultant fluctuation in internal projections, Action has had a long-standing policy of not disclosing to the public such information or any other projections of its future business which were prepared for internal purposes. J.A. 732-733, 755-757.

Petitioner has seriously mischaracterized Action's planning documents as reflecting "firm contractual com-

mitments." Petition at 4. As the court of appeals recognized, however, given the constant changes and cancellations of orders in Action's unique business setting, "the projections were changing constantly, with each new one rendering the last incorrect." 802 F.2d at 709. Moreover, contrary to petitioner's assertion that "[t]hese internal projections were highly accurate," Petition at 12, the court of appeals appropriately observed that "the projections [at issue here] failed to reflect accurately actual sales." 802 F.2d at 709.

(b) Action's Tender Offer.

On July 16, 1982, Action made a tender offer to its shareholders to purchase approximately 15% of its own common stock at the price of $4.00 per share. The stock was then selling on the American Stock Exchange for $3.25 per share. For those shareholders who wished to sell their shares, but who did not find it economically feasible to do so because of the very small trading volume in Action stock and the corresponding low prices, the tender offer provided an opportunity to sell their shares at a premium over the then-market price. For those shareholders who wished to retain Action stock, the repurchase of shares pursuant to the tender offer increased their percentage of equity ownership. These purposes were fully disclosed in Action's Tender Offer Statement which was issued in compliance with S.E.C. Rule 13e-4 and accompanying schedule 13E-4, 17 C.F.R. §240.13e-101 (1985). J.A. 3037.

At the time of preparation of the Tender Offer Statement, Action's fiscal year 1982 was just ending and the audited financial results of fiscal year 1982 were not yet available. The Tender Offer Statement therefore contained

the following narrative statement with respect to 1982 results:

> B. *Events Subsequent to March 27, 1982.* The Company's fiscal year ended on June 26, 1982. Although financial statements have not yet been prepared or audited, the Company expects results from continuing operations to reflect a sales increase compared with the prior year. However, earnings from continuing operations are estimated to be somewhat lower than last year as a result of lower gross margins on sales and higher operating expenses. The Company expects that the net earnings of Action Tungsram, Inc., in which it owns a 41% interest, will be substantially higher than last year . . .

J.A. 3038. The above narrative proved to be an exactly accurate description of 1982 audited financial results which were subsequently compiled and released to the public on August 18, 1982, 802 F.2d at 705, J.A. 744-745, and which were contained in a Form 10-K timely filed with the S.E.C.

The tender offer expired by its terms on August 6, 1982 without petitioner having tendered any of his shares to Action.

The court of appeals found that Action's Tender Offer Statement fully complied with the SEC regulations governing preparation of tender offer documents. 802 F.2d at 709. Moreover, the court held that there was no duty to disclose sales projections in the Tender Offer Statement. 802 F.2d at 706 n.5. *See* discussion, *infra.*

(c) Action's August 18, 1982 Press Release.

On August 18, 1982, Action issued a press release based upon audited financial statements for the fiscal year

ending June 26, 1982. J.A. 744-745; J.A. 3039. As with the Tender Offer Statement, it did not contain sales projections. The court of appeals found that the press release confirmed the statements made in the tender offer narrative regarding Action's financial performance in fiscal 1982. 802 F.2d at 705.

(d) Petitioner's Transactions with Action Stock.

Petitioner first purchased 2,000 shares of Action stock on April 22, 1982 on the recommendation of his stockbroker, James R. McIntire. J.A. 548. His purchase price for this transaction was $3.25 per share. 802 F.2d at 705; J.A. 548, 3748.

Stockbroker McIntire had maintained a close relationship and familiarity with Action and its key officers and directors for more than ten years. J.A. 548, 2206-2214. McIntire had personally analyzed Action's financial condition through study of its financial statements, attendance at shareholders' meetings, and extensive conversations with Action's officers and directors. J.A. 548, 557, 2031, 2032. In addition, McIntire had been employed as a broker on behalf of Action and had acted as a personal broker for Action's president, respondent Berez, and for one of Action's outside directors, Charles B. Cooper. J.A. 2206-2214. McIntire's knowledge of the history of Action and his analysis of its prospects were passed on to his customers, including petitioner, who traded in Action stock. J.A. 59-61, 548, 556-557, 2031-2032.

On July 21, 1982, petitioner had a conversation with McIntire about Action's tender offer. J.A. 66, 548, 555. At that time, petitioner purchased an additional 1,500 shares of Action stock at a price of $4.00 per share which was the same as the tender offer price. J.A. 549, 3748. Petitioner

made this investment decision without receiving or reading the Tender Offer Statement. 802 F.2d at 705; J.A. 556.

Petitioner testified that he thereafter received the Tender Offer Statement, read it, and decided not to tender any of his shares to Action for $4.00 per share. J.A. 558, 559. He testified that his decision to keep his Action stock and not to tender was influenced by the advice of his stockbroker McIntire.[3] J.A. 555-559.

On August 18, 1982, Action issued the press release announcing its audited 1982 financial results. 802 F.2d at 705; J.A. 3039. Petitioner became aware of Action's 1982 financial results and regarded those figures as consistent with what he had read in the Tender Offer Statement. 802 F.2d at 705; J.A. 550-551.

On September 21, 1982, a month and a half after the close of the tender offer and four days prior to the close of Action's first quarter of fiscal year 1983, petitioner spoke to his stockbroker, McIntire, and decided to sell all of his Action shares. 802 F.2d at 705; J.A. 551. He received approximately $5.25 per share, or total proceeds of over $18,000. 802 F.2d at 705; J.A. 560, 3748. His five-month profit on Action stock was over $5,000. J.A. 3748.

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[3] McIntire did not accept his own advice. He tendered the Action stock that he personally owned (28,300 shares) and subsequently filed a securities fraud class action against Action and its directors. *See* McIntire v. Action Industries, Inc., Civ. Action No. 83-0198-A (E.D. Va.). That suit was brought on behalf of himself and 21 of his customers, including one of Petitioner's counsel in the present case. All of these customers made their decisions to tender based upon the advice of their stockbroker, McIntire. J.A. 2353-2354. Contrary to petitioner's misleading characterization, Petition at 22 n.20, McIntire's suit was hardly "successful." After one day of jury trial, the *McIntire* case was settled after the trial judge made clear to counsel for plaintiffs that plaintiffs had little, if any, chance of prevailing before the jury. J.A. 2573-2579.

Petitioner testified that he was aware on September 21, 1982, that Action's first quarter of fiscal year 1983 was just ending and that he made his decision to sell his Action stock without obtaining first quarter results. J.A. 561-562. It is also to be noted that petitioner had an independent reason for selling his Action stock on that date, *i.e.*, his broker McIntire had recommended to him the purchase of options in two other stocks. J.A. 560-561. Petitioner accepted that advice, J.A. 82-83, sold his Action stock and invested the proceeds from the sale in the two stock options. J.A. 560-61, 3748. Petitioner subsequently realized a profit of $25,000.00 on the exercise of those options bought with the proceeds of his Action stock. J.A. 565, 3748.

(e) Action's Release of First Quarter Fiscal Year 1983 Results.

On October 28, 1982, more than two months into the historic "bull market" of 1982,[4] after compilation of the first quarter fiscal year 1983 results, Action issued a press release stating these results. 802 F.2d at 705; J.A. 3065. In that release, Action reported increased sales and profits. Thereafter, the price of Action stock rose on the American Stock Exchange along with the prices of most other stocks at the start of the bull market.

(f) Proceedings Below.

Disgruntled over the climb in Action's stock price after he sold all of his shares, petitioner, on behalf of himself and a proposed class, brought suit against respondents in the United States District Court for the Eastern District

[4] August 11, 1982, the week Action's tender offer was completed, marked the start of one of the strongest bull markets in the history of the stock market. J.A. 405-406, 566.

of Virginia. *Walker v. Action Industries, Inc.*, No. 84-0720-A (E.D. Va.). Petitioner alleged that respondents omitted alleged material facts in violation of S.E.C. Rule 10b-5 because they did not disclose internal sales projections in either the Tender Offer Statement of July 16, 1982, or the press release of August 18, 1982. Petitioner also sought damages on a state law claim for an alleged breach of fiduciary duty. Prior to trial, the district court denied petitioner's motion for class certification.

At the trial of this matter, at the close of petitioner's case, the district court granted a directed verdict on the state law claim. On the federal securities law claims, the jury returned a verdict in favor of all respondents.

Petitioner then appealed to the U.S. Court of Appeals for the Fourth Circuit. The court of appeals affirmed. *Walker v. Action Industries, Inc.*, 802 F.2d 703 (4th Cir. 1986). On the issue of internal sales projections, that court held that under the particular circumstances of this case, respondents clearly had no duty to make such disclosures, principally finding that given the uncertainty associated with respondents' orders, projections were by necessity an inaccurate predictor of sales and that the projections were "changing constantly, with each new one rendering the last incorrect." 802 F.2d at 707. In this connection, the court of appeals noted: "Indeed, in light of the disparity between actual and projected sales, we wonder whether Walker also would have sued had the disclosures been made, alleging that the projections were overly optimistic." 802 F.2d at 710. Further, the court of appeals found petitioner's proposed disclosure of projections to be "impractical, if not unreasonable" in that changes would have to be reported "virtually constant[ly]" in order to avoid misleading investors. *Id.*

Thus, under these circumstances, the court of appeals held that disclosure of projected sales would be both unreasonable and impractical. In so holding, the court below did not find that there was never a duty to disclose projections. Rather, it held that the facts in this case clearly did not support imposition of such a duty.

REASON FOR DENYING THE PETITION

The Ruling of the U.S. Court of Appeals for the Fourth Circuit is an Appropriate and Unexceptional Application of Federal Securities Laws and Does Not Conflict with Rulings in Other Courts of Appeals

The U.S. Court of Appeals for the Fourth Circuit held that Action had no duty to disclose its sales projections "under the circumstances of this case" and, hence, the District Court's jury instruction that there was no such duty to disclose was not reversible error. 802 F.2d at 710. Or, "[s]tated another way, as a matter of law, defendants' failure to disclose the financial projections was not an omission of material facts, which were necessary under the circumstances to make the statements made not misleading." 802 F.2d at 710 n.12.

Petitioner grossly distorts this holding in his Petition, describing the opinion below as establishing a "*per se* rule adopted by the Fourth Circuit that corporations and controlling insiders trading in their own stock have no duty as a matter of law to disclose material information, if such information is arguably based upon future projections or soft information . . . " Petition at 9. Although Petitioner constantly makes reference to insider trading. as if talismanic invocation of that "trendy" phrase will in and of itself prompt this Court to grant certiorari, this case has nothing whatever to do with the subject of insider trading.

The court of appeals emphatically stated that insider trading was not an issue in this case. *See* 802 F.2d at 710 n.13.[5]

More important, contrary to petitioner's misleading assertion, the court of appeals clearly stated that it was not adopting a *per se* rule in this case. Indeed the court below stated: "We *do not* hold that there is no duty to disclose financial projections under any circumstances." 802 F.2d at 710 (emphasis added). Rather, the court of appeals stressed the fact-sensitive nature of its holding: "Action had no such duty *under the circumstances of this case." Id.* (emphasis added).

Moreover, this case is not an appropriate vehicle for this Court to address broadly the larger issue of whether there are conflicting disclosure analyses among the various courts of appeals, as even if conflicting rules exist, *the court below expressly did not adopt any of them.* 802 F.2d at 709 n.11. Again, petitioner has misstated the court of appeals' holding in this regard. Petitioner argues that: "The Fourth Circuit's rule on the duty to disclose projections is in direct and acknowledged conflict with the rules enunciated by the Courts of Appeals for the Third, Sixth and Ninth Circuits." Petition at 17 (footnote omitted). This assertion is totally false: not only is there no conflict, there is no Fourth Circuit "rule"!

The court below expressly stated that it was not joining any of the other courts of appeals: "We *do not* specifically adopt any of the various positions held by the other

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[5]Petitioner also misleads this Court by stating that its holding in T.S.C. Industries, Inc. v. Northway, Inc., 426 U.S. 438, 96 S. Ct. 2126, 48 L.Ed.2d 757 (1976), is in direct conflict with the opinion below. In reality, there is no such conflict as *Northway* was concerned with the disclosure of established facts, whereas the instant matter involves only tentative projections.

circuits regarding whether a duty exists to disclose financial projections." 802 F.2d at 709 n.11 (emphasis added).

One of the positions specifically rejected by the court below, 802 F.2d at 707-08, and one that petitioner interestingly fails to mention as being held by any other circuit in his Petition, is the position articulated by the Court of Appeals for the Seventh Circuit that there is no duty under any circumstances to disclose *financial projections*. See *Panter v. Marshall Field & Co.*, 646 F.2d 271, 292 (7th Cir.), *cert. denied*, 454 U.S. 1092, 102 S.Ct. 658, 70 L.Ed.2d 631 (1981). *See also Gerstle v. Gamble-Skogmo, Inc.*, 478 F.2d 1281, 1294 (2d Cir. 1973) (Second Circuit in accord with respect to asset appraisals) and *Mendell v. Greenberg*, 612 F. Supp. 1543, 1550 (S.D.N.Y. 1985) (applying *Gerstle* to financial projections). The court below specifically declined to adhere to a position which never finds this duty to exist. In contrast, petitioner erroneously asserts that "the Fourth Circuit opinion holds that corporate issuers are not required to disclose such information even if there is a substantial likelihood that a reasonable investor would rely on such information." Petition at 12. This assertion is simply not supported by the opinion below.

One can only assume that petitioner's misstatements are motivated by the need to contrive a conflict where no conflict actually exists. No conflict exists because the court below recognized that Action had no duty to disclose the sales projections at issue in this case under the analysis of *any* of the courts of appeals. 802 F.2d at 707-710.

The opinion below surveyed the positions it perceived various courts of appeals to have taken on the issue of when a duty to disclose sales projections exists. 802 F.2d at 707-709. The Courts of Appeals for the Seventh and Second Circuits have held, as noted previously, that there is

no duty under any set of facts to disclose "soft information." 802 F.2d at 707-708. The Court of Appeals for the Third Circuit has held that the question of whether or not there is a duty to disclose "soft information" should be decided on a case by case basis. *Flynn v. Bass Brothers Enterprises, Inc.*, 744 F.2d 978, 988 (3d Cir. 1984). The Courts of Appeals for the Sixth and Ninth Circuits have held that there is no duty to disclose financial projections unless they are "substantially certain." *See, e.g., Starkman v. Marathon Oil Company*, 772 F.2d 231, 241-42 (6th Cir. 1985), *cert. denied*,—U.S.—, 106 S.Ct. 1195 (1986) and *Vaughn v. Teledyne, Inc.*, 628 F.2d 1214, 1221 (9th Cir. 1980).

With respect to any purported conflict, the Solicitor General of the United States has reviewed the opinions mentioned by the court below and concluded that: "Until the [Sixth and Third C]ircuits have both applied their potentially disparate tests in concrete factual circumstances, *any conflict remains, in our view, largely theoretical.*" Brief For The United States As Amicus Curiae, *Radol v. Thomas*, No. 85-1030 (U.S. Sup. Ct. 1986), at 15 (emphasis added). Indeed, the Solicitor General continued: "[s]everal factors suggest that any ostensible conflict between the general principles articulated by the two circuits could well prove illusory." *Id.* at 15 n.15.

With respect to this case, however, not even this illusory conflict is present. The court of appeals in its decision below, while explicitly *not* adopting any particular test from any other circuit, 802 F.2d at 709, held that Action had no duty to disclose its internal sales projections "*under the circumstances of this case.*" 802 F.2d at 709, 710 (emphasis added). The court of appeals reached this decision because *whatever disclosure test was used from*

whatever circuit, Action had no duty to disclose the particular, *unique projections* specifically at issue in this case. The court gave four separate and distinct reasons for reaching this conclusion.

First, it held there is no question but that Action made all of the disclosures of information required under S.E.C. Rule 13e-4, and its accompanying schedule 13E-4, 17 C.F.R. §240.13e-101 (1985), in its Tender Offer Statement and press release. 802 F.2d at 709.

Second, "the SEC has not imposed a duty to disclose financial projections in disclosure documents generally . . . [and] a further transition, from permissive disclosure to required disclosure, should be occasioned by congressional or SEC adoption of more stringent disclosure requirements for financial projections, rather than by the courts." *Id.*

Third, the court held that Action's internal sales projections were far from being "substantially certain." *See Starkman v. Marathon Oil Company*, 772 F.2d 231, 241-42 (6th Cir. 1985), *cert. den.*—U.S.—, 106 S. Ct. 1195 (1986), and *Vaughn v. Teledyne, Inc.*, 628 F.2d 1214, 1221 (9th Cir. 1980). The court reasoned that, given these particular facts, "*we are reluctant to recognize a duty to disclose financial projections in this case because of their uncertainty and their potential to mislead investors.*" 802 F.2d at 709 (emphasis added). The court continued: "Clearly, the projections were changing constantly, with each new one rendering the last incorrect. A disclosure of the May or June projections would have grossly understated subsequent projections. Furthermore, the projections failed to reflect accurately actual sales . . . *Because of*

the evident uncertainty and misleading nature of the projections, we deem it unwise to require their disclosure." Id. at 709-10 (emphasis added).

Fourth, the court below held that mandating disclosure of Action's internal sales projections (which were issued weekly and changed even more frequently) would be unmanageable: "Because of the frequency and volatility of these projections, the imposition of a duty to disclose them would have required virtually constant statements by Action in order not to mislead investors. Under these circumstances, we deem the projection disclosures urged by Walker to be impractical, if not unreasonable." 802 F.2d at 710.

Quite obviously, and contrary to petitioner's assertions, the court below did not adopt a disclosure rule for sales projections because there was no need to do so in these particular circumstances. On the unique facts of this case, the court concluded that under *any* of the courts of appeals' analyses, Action would not have been required as a matter of law to make the disclosures of internal sales projections petitioner unreasonably demands. 802 F.2d at 709-710. Therefore, the disclosure of projections question would not have been resolved differently had this matter been heard in any of the other courts of appeals. Petitioner is simply incorrect when he suggests otherwise. Petition at 19.

CONCLUSION

Petitioner is a disgruntled speculator who sold his stock in Action for a sizeable profit, although less than he might have realized had he held his shares longer. Petitioner lost his claim that Action did not make a full and fair disclosure before a jury and he lost again before the U.S. Court of Appeals for the Fourth Circuit which not only deemed his complaints unmeritorious, but termed his disclosure demands "unreasonable."

In affirming the district court, the court of appeals covered no new nor controversial ground, but rather held that Action had no obligation to disclose internal sales projections under any disclosure analysis used by any federal court of appeals. Because the judgment below was fair and reasoned and because the opinion below is not in conflict with the other courts of appeals which have addressed the issue, respondents respectfully urge this Court to deny the Petition For Writ Of Ceriorari.

Respectfully submitted,

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